No. 8079

# In the United States
# Circuit Court of Appeals
## For the Ninth Circuit.

Obispo Oil Company, a corporation,
*Appellant,*

*vs.*

Galen H. Welch, Collector of Internal Revenue for the Sixth Collection District of California,
*Appellee.*

## BRIEF FOR APPELLANT.

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*Appellee.*

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## BRIEF FOR APPELLANT.

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## STATEMENT OF THE CASE.

This case comes before this court on an appeal from a decision of the District Court of the United States for the Southern District of California, Central Division. The judgment of the court below was entered on December 7, 1935. A petition for appeal was filed on December 13, 1935, and subsequently has been perfected and docketed in this court for hearing on April 8, 1936.

This case involves a suit by the Obispo Oil Company, a corporation, hereinafter referred to as "appellant," against Galen H. Welch, Collector of Internal Revenue

for the Sixth District of California, hereinafter referred to as "appellee," for the recovery of income and profits taxes alleged to have been assessed and collected erroneously on appellant's return for the calendar year 1920. Only the income taxes are involved in this appeal.

On June 17, 1931, the court below entered a judgment in the present proceeding in the full amount claimed in the complaint. As shown in the Opinion, reported at 48 Fed. (2d) 872, said judgment was based upon the holding that certain income from oil production, impounded by order of court on and after March 11, 1914 and released to appellant in 1920, was taxable in the years when and as realized, and not all in 1920, as held by the Treasury Department. In said Opinion, the court did not pass upon certain other and alternative claims of appellant.

In due course an appeal was taken by appellee to this court. While the appeal was pending, the Supreme Court handed down its decision in *North American Oil Consolidated v. Burnet*, 286 U. S. 417, promulgating in an analogous case legal principles inconsistent with the Opinion of the court below. Believing that the Supreme Court decision was controlling on that issue in the present case, counsel for both parties filed a joint motion in this court to remand the case to the court below for a new trial. The motion was granted by this court, and a mandate was issued accordingly.

On October 21, 1933, amended pleadings were filed by both parties, together with a written Stipulation of Facts

which, including by reference the evidence introduced at the first trial, constitutes all the evidence in the case. A jury trial was waived, by written stipulation. [Tr. 22.] As a result of the amended pleadings and the Stipulation of Facts, both parties conceded error on various minor issues and left to the court for determination the following issues:

> 1) Did the proceeds from the operation of oil lands, impounded by a receiver through a court order during the years 1914 to 1920 pursuant to litigation with the Federal Government regarding the title to said lands, represent a gift from the Government which was not taxable as income?
>
> 2) If such proceeds constituted taxable income in 1920, when released, what depletion allowances were deductible by appellant with relation thereto?

Thereafter, on November 10, 1933, while the case was still under submission, appellee filed a Motion for Judgment contending that the court below had no jurisdiction of the subject matter, because the profits tax was determined under the "special assessment provisions of sections 327 and 328 of the Revenue Act of 1918." [Tr. 23.] With respect to this point, counsel for appellant conceded on brief below that the court had no jurisdiction to make any change in the profits tax determination but contended that the court had jurisdiction to determine the correct amount of income tax on the basis of the court's determination of the taxable net income.

On May 21, 1934, the court below handed down a memorandum opinion [Tr. 25] holding as follows:

1) That the court had jurisdiction.

2) That the amount of money received by appellant from the receiver in 1920 did not constitute a gift.

3) That appellant was entitled to a deduction for depletion only on income received from the property after April 30, 1920, when appellant received its lease from the Government.

On September 13, 1935, the court below entered its Findings of Fact and Conclusions of Law, in accordance with its memorandum opinion, with exceptions noted for both parties. Thereafter, on December 7, 1935, the court entered a judgment for appellant in the amount of $4,010.24, together with interest and costs. In determining the amount of said judgment, the court below made no change in the profits tax determined by the Commissioner.

Within the time allowed by law, appellant has perfected an appeal to this court from the adverse decision of the court below on the issues raised by it. To date, no cross-appeal has been filed by appellee with respect to the issue raised by it on jurisdiction; however, this question would appear to be settled, in accordance with the ruling of the court below, by the decision of this court in *Welch v. St. Helens Petroleum Co., Limited,* 78 Fed. (2d) 631, 636.

The only questions pending before this court are, as outlined above, 1) whether the proceeds of oil production turned over to appellant in 1920 were a gift and therefore not taxable income, and 2) if such proceeds represented taxable income, to what depletion deduction was appellant entitled with respect thereto.

There is no issue between the parties as to the facts, most of them having been stipulated. Appellant raises no issue regarding the Findings of Facts of the court below, but only as to the court's Conclusions of Law.

In the event this court finds that the proceeds of prior oil production turned over to appellant in 1920 represented a gift, it will be unnecessary to consider the question of depletion. If this court holds that these proceeds constituted taxable income to appellant in 1920, and that appellant is entitled to a depletion allowance in accordance with the law then in force, the parties have stipulated the amount which would be deductible.

Accordingly, the only issues in this case are questions of law. In the following Statement of Facts, we have attempted to summarize the relevant facts on the issues in controversy. For further details, reference may be had to the Findings of Fact of the court below. [Tr. 26-41.]

## STATEMENT OF FACTS.

Appellant, prior to 1914, was engaged in the development and production of crude petroleum. It was a successor to a claim of title held under a placer mining location, made in the year 1900, covering forty acres of land in the Kern River District of California. Said land as of June 9, 1909, was classified by the Secretary of the Interior as oil bearing and it came within the effect of a withdrawal order issued by President Taft on September 27, 1909, which purported to withdraw designated areas from all forms of "location, settlement, filing, entry or disposal." Said withdrawal order contained the condition that "all locations or claims existing and valid at this date may proceed to entry in the usual manner after field investigation and examination." In June, 1910, Congress passed an Act, 36 Stat. L. 847 (amended August, 1912, 37 Stat. L. 497), giving express authority to the President to issue withdrawal orders, with the limitation that *bona fide* occupants or claimants of oil or gas lands, who at the date of the withdrawal order were in diligent prosecution of work leading to discovery, should not have their rights impaired. [Tr. 27, 28, 30.]

At the date of the withdrawal order, appellant had made exploration for oil but had not at the time discovered same, but did make such discovery in June, 1910. Notwithstanding said withdrawal order, appellant maintained possession of the land in question and drilling operations were prosecuted. In December, 1913, a well was completed, which became a heavy producer of oil. Other wells were thereafter drilled and the output was thereby increased. [Tr. 28.]

On or about March 1, 1914, the United States of America filed a bill of complaint in the United States District Court of California, Southern District, against appellant and others to oust them from possession and to recover proceeds of oil theretofore produced. On or about March 11, 1914, said court appointed a receiver to take charge of the property, with directions to impound the proceeds therefrom pending termination of the litigation. From that time until the year 1920, appellant proceeded to produce and market oil under the direction of the receiver, turning over the proceeds to the latter. During this period, appellant kept its books on an accrual system of accounting and accounted for the income received from the sales of oil during each of the years 1914 to 1920 as separate and independent years, charging the receiver with said amounts on its books. Likewise, appellant made its income tax returns for each of said years to the United States Government, and therein accounted for income and profits as though it were in undisputed ownership and possession. [Tr. 28-29.]

On or about December 24, 1919, the District Court entered its decree in favor of the United States Government, holding that appellant and the other parties had no estate, right, title or interest in the property and directing the receiver to turn over possession of the land and fixtures to the United States. Thereafter, appellant perfected its appeal to this Court, claiming that it was holding under a valid location which, having been completed prior to the withdrawal order of September 27, 1909, was unaffected thereby. [Tr. 29-30.]

Before said appeal came up for hearing before this Court, Congress passed an Act, approved February 25,

1920, entitled "An Act to promote the mining of coal, phosphate, oil, oil shale, gas and sodium on the public domain." Section 18 of said Act provided that upon relinquishment of all right, title and interest claimed and possessed prior to July 3, 1910, and continuously thereafter by a claimant to any oil and gas land upon which one or more wells had been drilled to discovery, and upon payment to the United States of an amount equal to one-eighth of the value at the time of production of all oil and gas produced on the property, such claimant should be entitled to a lease thereon from the United States for a period of twenty years, at a royalty of not less than 12½ per cent. [Tr. 31.]

On April 30, 1920, appellant made request to relinquish all its right, title and interest claimed and possessed in this property and to take a lease as provided in said Act. Said request was approved by the Commissioner of the General Land Office, who reported his view to the Secretary of the Interior, in the course of which communication he said:

> "I have, therefore, the honor to recommend that the Attorney General be requested, in the absence of any objection which may be a bar to such action, to cooperate with this department with a view to securing a dismissal of the suit, the payment to the United States of the ⅛ value of past production, and the release of the remaining funds to the applicant company. I have also to recommend that the applicant be granted a lease, substantially in the form set out in the leasing regulations, for a term of twenty years, with a provision for the payment of the royalty prescribed in the leasing regulations." [Tr. 31-32.]

On April 30, 1920, appellant filed in the United States Land Office at Los Angeles, California, its unconditional quitclaim to the land in question and, on November 29, 1920, paid to the Federal Reserve Bank of San Francisco, California, for the credit of "Receiver of Public Moneys United States Land Office, Los Angeles, account Lease Application 032892", the principal amount of $248,406.83, with interest of $6,317.81, representing an amount equal to ⅛ of the value at the time of production of the oil and gas theretofore produced. [Tr. 32.]

On November 29, 1920, this Court directed, in accordance with a stipulation filed by the parties, a mandate to the United States District Court ordering a discharge of the judgment therein against appellant and the turning over to it by the receiver of possession of the land, together with all funds impounded by order of said court. On November 30, 1920, an order was entered in the District Court complying with said mandate, and the receiver turned over to appellant all the moneys and other assets theretofore impounded by order of said court. [Tr. 33.]

On its income tax return for the calendar year 1920, here in question, appellant reported only the income from oil and gas produced during said year. Upon audit, the Commissioner of Internal Revenue charged as income to appellant the total proceeds turned over by the receiver, less the amount paid to the United States Government. As a result, the Commissioner increased appellant's taxable net income in the amount of $1,378,-077.32, and assessed an additional tax of $264,017.74, which was paid on July 23, 1936, with interest. [Tr. 33-34.] At about the same time, the Treasury Department refunded to appellant taxes, with interest, paid on said

income on its returns for the years 1914 to 1919. [Tr. 39-40.]

Thereafter, on December 6, 1927, appellant filed a claim for refund covering said amounts, alleging in support thereof various grounds, including the present contentions of appellant. [Tr. 34-36.] On February 14, 1928, said claim was rejected and on December 2, 1928, appellant filed its original complaint in this case. [Tr. 37.]

In computing the taxable net income of appellant for the calendar year 1920, the Commissioner of Internal Revenue allowed a depletion deduction of $152,571.96, computed on the basis of the production for the various years 1914 to 1920, under the revenue laws then in force. [Tr. 37.] The detailed determination of said deduction is set forth on page 38 of the transcript of record. Of said amount, $126,427.49 related to oil and gas produced prior to April 30, 1920. [Tr. 39.]

On December 23, 1913, appellant made discovery of oil as defined in section 234(a) (9), Revenue Act of 1918, on the lands in question. The fair market value of the oil content at date of such discovery was greatly in excess of the cost of said property, and said oil content was unknown prior to December 23, 1913. [Tr. 37.] The details regarding the production and the depletion sustained on a discovery basis are set forth on page 38 of the transcript of record. The total depletion sustained on the discovery value basis on the oil produced from March 10, 1914, to April 30, 1920, was $621,201.20. [Tr. 39.]

The Commissioner of Internal Revenue determined that the taxable net income of appellant for the year 1920 was $1,476,330.52, and determined under sections 327 and 328,

Revenue Act of 1918, that the profits tax was $142,765.73. Said amount, together with other items totalling $88,-134.16, were allowed as deductions in computing the income subject to the 10 per cent income tax, $1,245,430.63. The amount of said income tax was determined to be $124,543.06. [Tr. 40.] The court below, on the basis of its Conclusions of Law, determined that appellant's net income as determined by the Commissioner was excessive in the net amount of $40,102.44, upon which the income tax at the rate of 10 per cent, was $4,010.24, and ordered judgment for said amount, with interest and costs. [Tr. 42-43.]

## STATUTES INVOLVED.

*Revenue Act of 1918*, c. 18, 40 Stat. L. 1057:

Section 213. That for the purpose of this title (except as otherwise provided in Section 233) the term "gross income"—

* * * * * * * *

(b) Does not include the following items which shall be exempt from taxation under this title:

* * * * * * * *

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income):

* * * * * * * *

Section 233(a). That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, except that:

* * * * * * * *

Section 234(a). That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * * *

(9) In the case of * * * oil and gas wells * * * a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: * * * *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * * * * *"

*Leasing Act of February 25, 1920,* c. 85, 41 Stat. L. 443:

*"Section 18. Leases to persons relinquishing rights under prior claims on withdrawn lands under preexisting placer mining law; claims on naval petroleum reserves; fraud of claimant; adjustment of suits*—Upon relinquishment to the United States, filed in the General Land Office within six months after February 25, 1920, of all right, title and interest claimed and possessed prior to July 3, 1910,

and continuously since by the claimant or his predecessor in interest under the preexisting placer mining law to any oil or gas bearing land upon which there has been drilled one or more oil or gas wells to discovery embraced in the Executive order of withdrawal issued September 27, 1909, and not within any naval petroleum reserve, and upon payment as royalty to the United States of an amount equal to the value at the time of production of one-eighth of all the oil or gas already produced except oil or gas used for production purposes on the claim, or unavoidably lost, from such land, the claimant, or his successor, if in possession of such land, undisputed by any other claimant prior to July 1, 1919, shall be entitled to a lease thereon from the United States for a period of twenty years, at a royalty of not less than 12½ per centum of all the oil or gas produced except oil or gas used for production purposes on the claim, or unavoidably lost: * * *

All such leases shall be made and the amount of royalty to be paid for oil and gas produced, except oil or gas used for production purposes on the claim, or unavoidably lost, after the execution of such lease shall be fixed by the Secretary of the Interior under appropriate rules and regulations: * * *

* * * * * * * *

Upon the delivery and acceptance of the lease, as in this section provided, all suits brought by the Government affecting such land may be settled and adjusted in accordance herewith and all moneys impounded in such suits or under section 104 of this title shall be paid over to the parties entitled thereto * * *"

## SPECIFICATION OF ERRORS.

The court below erred [Tr. 50-51]:

1. In failing to find that the proceeds received by appellant from the receiver in 1920 constituted a gift not subject to the income tax.

2. In failing to find that appellant was entitled to an additional depletion deduction in 1920, of $516,598.10, computed under section 234(a) (9), Revenue Act of 1918, on the discovery basis, on the oil produced during the period of the receivership.

## SUMMARY OF ARGUMENT.

1. If appellant is not entitled to depletion with respect to the oil production during the receivership, it must be on the ground that it had no interest whatever in this property, or the impounded funds, prior to April 30, 1920, when it received a lease from the Government. If appellant had no such interest, the voluntary relinquishment by the Government was a pure gift to appellant, which was expressly not subject to the income tax. The courts have held that mining claims to lands granted by the Government were gifts and not taxable. (*U. S. v. Hurst,* 2 Fed. (2d) 73; *Barnes v. Poirer,* 64 Fed. 14.) In *Edwards v. Cuba R. Co.,* 268 U. S. 628, the Supreme Court held that similar subsidy payments by a government to a corporation did not constitute taxable income. The same principle has been applied to contributions or gifts from non-governmental parties. (*Liberty Light & Power Co.,* 4 B. T. A. 155; *Kauai Ry. Co.,* 13 B. T. A. 686.)

2. If said proceeds did not constitute a gift to appellant, it had an economic interest in the property during the years in which the proceeds of production were impounded and is entitled to depletion with respect thereto (*Palmer v. Bender,* 287 U. S. 551; *Signal Gasoline Corp. v. Commissioner,* 66 Fed. (2d) 886.) Where the income is impounded under such a receivership, it is subject to income taxation for the taxable year in which it is actually released to the recipient. (*North American Oil Consolidated v. Burnet,* 286 U. S. 417.) In such a case, the amount of depletion allowable must be computed under the revenue act in force at the time of receipt, here the Revenue Act of 1918. (*National Petroleum & Refining Co.,* 28 B. T. A. 569; *Ralph W. Crews,* 30 B. T. A. 615. See also *Aubrey Umsted et al.,* 28 B. T. A. 176, affirmed, 72 Fed. (2d) 328.) Income and depletion should go hand in hand and the allowance for depletion should be made in the year in which the income is subjected to tax. (*Champlin v. Commissioner,* 78 Fed. (2d) 905.) The Treasury Department has held that under the Revenue Act of 1918, taxpayers deriving income from such impounded funds have a depletable interest and are entitled to a depletion deduction thereon for the taxable year in which the income is received. (Solicitor's Opinion 1110, C. B., II-1, p. 104.)

## ARGUMENT.

### I.

### The Amounts Received by Appellant From the Impounded Funds in 1920 Represented a Gift or Contribution by the Government and Did Not Constitute Taxable Income to Appellant.

Unfortunately, the court below in its memorandum opinion gave no explanation for its rulings, on the one hand to the effect that these funds did not constitute a gift and, on the other hand, that appellant was not entitled to depletion. We submit that these rulings are absolutely inconsistent in principle and in logic. We contend as follows:

1) If appellant did not have a depletable interest in the oil production prior to April 30, 1920, then the impounded funds turned over to it represented a pure gratuity or gift from the Government and therefore is expressly excluded from taxation.

2) If, on the other hand, appellant did not receive the impounded funds as a gift, they must have been derived from an economic interest in the oil property held by appellant prior to the settlement with the Government.

Referring to the first point, counsel for appellee argued to the court below that appellant had absolutely no right, title or interest in the oil property or in the impounded funds prior to the settlement with the Government and, accordingly, that it was not entitled to depletion. Apparently, counsel relied upon the judgment of the trial court which was up on appeal. Appellant takes direct issue with such contentions, believing at all times dur-

ing the receivership as well as at the present time that it had fully perfected its claims to this oil land and that the withdrawal order was ineffective and did not apply to it.

However, following the Government's contention to its logical conclusion, if appellant had absolutely no right, title or interest in the property, Congress must have intended to make a gift to appellant when it provided in the Leasing Act of 1920 for appellant to receive approximately seven-eighths of the impounded funds.

It cannot be denied that Congress may authorize or direct that such gifts be made. On the contrary, such gratuities have been frequent throughout the history of this country, the following being notable instances:

(a) Land grants to railroads.

(b) Homestead grants of land.

(c) Mining and placer land grants and permits.

Since the grantee in each of the above instances had no prior interest in the property and the Government received no direct consideration therefor, it would seem impossible to analyze these grants as being anything other than voluntary gifts or contributions; and all the judicial decisions in point are to that effect.

In *U. S. v. Hurst,* 2 Fed. (2d) 73, the District Court (D. Wyoming) held that a mining claim, based solely on discovery and location was a gift, exempt from income tax. The court there placed considerable reliance upon the decision of this Court in *Barnes v. Poirer,* 64 Fed. 14, holding that "soldiers scrip" represented an absolute and assignable gift from the Government.

In *Edwards v. Cuba R. Co.*, 268 U. S. 628, the Supreme Court held that subsidy payments made by the Republic of Cuba to a New Jersey corporation which built a railroad in Cuba, did not constitute taxable income within the meaning of the Sixteenth Amendment.

Nor is this principle limited in application to gifts made by governments. (See *Liberty Light & Power Co.*, 4 B. T. A. 155; *Aransas Compress Co.*, 8 B. T. A. 155; *Kauai Ry. Co.*, 13 B. T. A. 686.) In the above cases involving contributions of transmission lines, spur tracks, and land by private citizens to companies to induce them to enter the community, the Commissioner of Internal Revenue has announced acquiescence. Accordingly, these decisions are binding in principle on the Treasury Department. (See also, to the same effect, G. C. M. 1581, C. B., VI-1, page 197. Note also the decision of this Court in *Blair v. Rosseter*, 33 Fed. (2d) 286.)

If, as contended by appellee, appellant had no right, title or interest in the property, it seems obvious that the impounded funds were received as a gift or grant from the Government and did not constitute taxable income. Nor would such a result be unusual or inequitable. The Government clearly can give away valuable mining patents and land grants without the realization of taxable income by the grantees, even though subject to the conditions of discovery and production. Likewise, in a case where the taxpayer has done considerable exploratory and productive work on an oil claim but (as contended by appellee herein) has not obtained any interest in the property or the proceeds, a gift of seven-eighths of such proceeds would be as clearly non-taxable.

II.

## Appellant Is Entitled to a Depletion Deduction With Respect to the Income, if Any, Realized From the Receipt of the Impounded Funds in 1920.

So far as we are advised, the Commissioner of Internal Revenue has uniformly allowed depletion deductions with respect to impounded funds, in cases like that here presented. In Law Opinion 1110, C. B., II-2, C. B., page 104, still in full force and effect, the Department ruled that taxpayers who made settlements in accordance with the Leasing Act of 1920, no final adjudication having been made as to the title or interest, had depletable interests in the property and accordingly were entitled to depletion under section 234(a) (9), Revenue Act of 1918. This opinion is so clear in its analysis of the legal situation and so convincing in its conclusions that we are reproducing it in full in the Appendix herewith, for the convenience of the Court.

Likewise, in the present case, the Commissioner of Internal Revenue determined that appellant had a depletable interest in the property and allowed a deduction of $126,-427.49 with respect to the oil and gas production from March 10, 1914, to April 30, 1920, inclusive, covering the period of receivership. The only flaw in the Commissioner's depletion determination was that while he subjected all the income to taxation at 1920 rates under the Revenue Act of 1918, he determined the depletion allowance on the basis of the various laws in force during the respective years of production. Thus, for example, with respect to 321,045 barrels produced in 1915, the Commissioner allowed a depletion deduction of $6,703.42, based on the Revenue Act of 1913, then in force; where-

as, the correct amount of depletion, determined under the Revenue Act of 1918, under which the income is taxed, is $87,584.29. [See schedules on page 38 of the Transcript of Record.] Appellant has consistently contended that its depletion allowance should be determined under the same Act which governs the computation of its taxes, the Revenue Act of 1918.

On June 28, 1933, the Tax Board promulgated its decision in *National Petroleum & Refining Co.,* 28 B. T. A. 569. In that case, the taxpayer received in 1924 certain funds impounded over a period of years by order of court pending litigation over the title to the oil land. The Commissioner held that all the impounded funds constituted taxable income for the year 1924 and also computed the depletion allowance on the basis of the Revenue Act of 1924. The taxpayer took the position (as did the Commissioner in the present case) that the depletion allowances should be computed under the laws effective during the years of actual production which would have given it a higher deduction. In upholding the Commissioner, the Board said in part:

> "In support of its second point, petitioner argues that inasmuch as the actual production of oil from its property was for the most part in years in which the Revenue Act of 1921 was effective, allowable depletion must be computed in conformity with the provisions of that act. We are unable to agree with this contention. Allowances for depletion represent the return of capital cost free from tax and are applicable to years in which income is derived from the property. As we have decided above that all the income in question was received in the taxable year, we think it is clear that deduction for depletion

allowances must be taken under the Revenue Act of 1924, which was in effect when the income in question was realized."

It should be noted that the Board's decision in the above case was in favor of the Government and upheld exactly the same contention which appellant makes in the present case. Adopting this principle, the depletion allowance herein must be determined under section 234(a) (9), Revenue Act of 1918.

After the Board's decision in the *National Petroleum & Refining Co.* case, appellee herein filed an amended answer [Tr. 14] in which was raised for the first time the claim that appellant is entitled to no depletion allowance. [Tr. 17.] Apparently, this contention was an after-thought, raised when the Board's decision made it clear that the depletion allowance should be determined in this case under the Revenue Act of 1918.

In *Ralph W. Crews,* 30 B. T. A. 615, the Board followed its previous decision and held that all deductions, including depletion, in connection with the taxability of the income involved are allowable in the year of the release of the impounded funds and in conformity with statutory provisions then effective. In the *Crews* case, as here, a lump sum settlement was made while the litigation was still pending and there never was any final adjudication of the controversy. (See also *Everett J. Crews,* 33 B. T. A. 36.) The Commissioner has announced acquiescence in these decisions. (Internal Revenue Bulletin, XV-1, 7885.)

Another decision rather closely in point is *Champlin v. Commissioner,* 78 Fed. (2d) 905 (C. C. A.—10), in which the taxpayer was held entitled to full depletion,

despite title litigation. After pointing out that litigation over titles is a usual occurrence after discovery of oil but that there were no decisions or rulings denying or reducing depletion allowances on that account, but on the contrary, Law Opinion 1110 allowed such depletion, the Court said in part:

> "The rule that income and depletion should go hand in hand seems not only to be the settled and practicable rule, but it is without question the just one.
>
> * * * * * * * *
>
> "Why should petitioner be denied his depletion allowance because he might later be required to account to his adversary for oil produced? Petitioner developed this field in the face of a serious title hazard; he has returned as income the full proceeds of all oil recovered; he must pay his full tax thereon despite the chance that later he might lose it; we see no reason at all why he should be denied depletion because of that hazard. The government loses nothing. If petitioner's title had been clear, concededly he would have been entitled to the depletion allowed by the Commissioner and disallowed by the Board. That he might later be required to account to his adversary in the litigation over the title affords no reason, as we see it, why his taxes should be so greatly increased."

Before entering into an analysis of the facts regarding the litigation over appellant's title with the Government and the nature of its interest in the property, we will point out several recent decisions of the Supreme Court bearing on the question of depletion.

In *Palmer v. Bender,* 287 U. S. 551, the Supreme Court held that the taxpayer was entitled to depletion under an

oil and gas lease even though he had assigned his full interest in consideration of a bonus and royalties. The court said in part (pp. 556-7):

> "Section 214(a) (10) of the Act of 1921 so far as now material is printed in the margin. It will be observed that the statute directs that reasonable allowance for depletion be made as a deduction in computing net taxable income, 'in the case of oil and gas wells, * * * according to the peculiar conditions in each case.' The allowance to the taxpayer is not restricted by the words of the statute to cases of any particular class or to any special form of legal interest in the oil well * * * *The language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital.*" (Italics supplied throughout this brief.)

In the above decision, the Supreme Court held that any economic interest in the oil production or the proceeds therefrom would form a sufficient basis for a depletion allowance.

In *Herring v. Commissioner,* 293 U. S. 322, the Supreme Court held that a depletion deduction should be allowed with respect to a cash bonus received for making an oil and gas lease, even though there was no production at all from the property during that year. The court adopted the general principle that the deductions should follow the income.

For a review of the depletion provisions under the various acts, see *Helvering v. Twin Bell Oil Syndicate,* 293 U. S. 312.

In *Signal Gasoline Corporation,* 66 Fed. (2d) 886, this court also considered the question of depletable interests. After reviewing the decision of the Supreme Court in *Palmer v. Bender, supra,* this court said in part:

> "Accordingly, the right to a depletion allowance does not depend upon the nature or character of the legal estate retained or acquired by the parties to an original oil and gas lease or their successors, but depends entirely upon whether any such parties are entitled to share in the oil and gas produced from the properties. *If any of such parties are entitled to a share of the oil and gas, he had the 'economic interest' upon which the Supreme Court bases the right to a depletion allowance."*

Applying the above principle to the facts in the present case, we submit that appellant clearly had a depletable interest in the oil property pending termination of the title litigation and is entitled to a depletion deduction with respect of the income therefrom taxed to it in the year 1920.

The history of appellant's litigation with the Government and the manner in which it was terminated is reviewed at some length in the first opinion of the court below, reported at 48 Fed. (2d) 872. The following facts should be noted particularly:

> 1) Prior to the suit by the Government, appellant was in possession of, and operating the property, under a claim of full legal title.

2) Appellant had a very substantial investment in the property, having drilled wells and made very substantial discoveries.

3) During the receivership, the property was operated by appellant, who returned the proceeds to the receiver and reported the income therefrom currently.

4) While the decision of the trial court was adverse to appellant on the question of title, an appeal was perfected to this court. Accordingly, the judgment of the court below is of no evidentiary value. See *Di Nola v. Allison,* 143 Cal. 106, 112; *Contra Costa Water Co. v. City of Oakland,* 165 Fed. 518; *Harris v. Barnhart,* 97 Cal. 546; *Purser v. Cady,* 120 Cal. 214.

5) There was never any judicial determination of the title question on the merits. The mandate of this court was based upon a stipulation of the parties.

6) Said stipulation was entered into pursuant to the terms of the Leasing Act of 1920 and was predicated upon a claim of right and possession.

7) Before said stipulation was filed, appellant had to deed to the Government all its right, title and interest to the property. This would have been a futile procedure had appellant possessed no interest whatever.

8) Appellant was required to pay "as royalty to the United States" an amount equal to one-eighth of the value of the production, irrespective of the value of the impounded funds. This clearly recognized that appellant was owner of the oil proceeds, subject only to a royalty payment.

9) The impounded funds never went into the possession or control of the Government. Upon termination of the litigation, all the impounded funds were turned over to appellant by order of court.

10) Under the settlement, appellant was permitted to retain seven-eighths of the oil proceeds, a clear recognition of its substantial "economic interest" in the property.

It is not the function of the Commissioner, in auditing returns, to conduct moot trials of title suits which have already been settled by agreement of the adverse parties in interest. Irrespective of the reasonableness of the settlement and even if the Commissioner thinks one party gave up valuable rights unnecessarily, we submit that the income tax burdens and benefits must be determined on the basis of the actual settlement and the final decree of the court. What right has the Commissioner to go behind such a settlement and judgment and determine that a party who received under them seven-eighths of what he was claiming, nevertheless had no right, title or interest in the property?

If the Commissioner has the right or power to determine in the present case that, despite the very favorable terms of the settlement, appellant had no economic interest in this property—a question never determined on the merits by the courts—then he can look behind and remake any private contracts and at the same time usurp the prerogatives of the courts. For example, if two manufacturing companies litigating the title to basic patents should enter into a settlement under which their interests were pooled or allocated, could the Commissioner properly re-

fuse to abide by such a settlement and undertake to try anew the question of title? Not only is such action contrary to the fundamental principles of law, but it would lead to hopeless confusion in the administration of the tax law.

As stated by the court below in its original opinion (48 Fed. (2d) 872, 874):

> "* * * But, in this case, neither can there be a question but that the government, by its lease settlement, recognized that the plaintiff had some right which might be by the courts adjudicated in its favor, The leasing act provided a means of settlement of controversies. By such settlement, the government conceded the right in the plaintiff to have the proceeds of the oil as separately received during the different years of the receivership. That money had been identified and determined in amount at and for each of those years. There was nothing contingent about the amount or the fact of possession thereof in the hands of the receiver. *When the government settled its case with the plaintiff, it ratified the claim of plaintiff to each of the separate amounts of production return, with the contract condition that one-eighth thereof should be paid over.* * * *
>
> "* * * When the settlement was made it related back and assured the title of plaintiff to seven-eighths of the oil sales proceeds as collected during the separate years * * *."

This statement by the court, which is fully borne out by the record, shows clearly that appellant did not receive merely a sum of money to satisfy a nuisance value claim, but was recognized to be substantially the full owner of

the proceeds of the oil produced by it from this property under a claim of right.

Furthermore, the Treasury Department has recognized, not only in the tax determination in the present case, but in its rulings, that taxpayers who settled their controversies under the Leasing Act of 1920 are entitled to depletion with respect of the impounded funds. As stated above, we are reprinting in an Appendix attached to this brief Law Opinion 1110, C. B. II—1, p. 104, promulgated in January, 1923, and never revoked. This entire Opinion by the Solicitor of Internal Revenue is of interest because of its painstaking review of the legal situation. Referring to the Leasing Act of 1920, the Opinion stated (p. 109):

> "The claimants were to receive a lease to the land and all the profits theretofore made by the operation of the properties, other than the one-eighth royalty, turned over to the Government. *The substantial effect of this settlement was to treat the oil claimants as if they had been operating under a lease from the Government from the beginning.*"

Referring to the economic interests of the claimants prior to the settlements, the Opinion stated in part:

> "That the interest of the taxpayer had a very substantial value is evidenced by the large amounts for which a number of the properties involved were conveyed prior to and during 1913. Without attempting to give a more comprehensive name to the interests of the taxpayers in the oil properties on March 1, 1913, *there is no question that at that time and at all subsequent times until the acceptance of a lease from the Government the taxpayers had such an interest in the properties in question sufficient to bring them*

> *within that term as used in section 214(a) (10) of the Revenue Act of 1918, i.e., such an interest as to entitle them to the depletion allowance provided in the statute."*

It should be noted that appellee in the present case is a former Collector of Internal Revenue, not the United States Government or the Commissioner of Internal Revenue. Unless this accounts for the inconsistency, it is impossible to reconcile appellee's contentions in this case with Law Opinion 1110 or with the continuous recognition by the Commissioner of a depletable interest in situations of this kind.

A case of particular interest in connection with both the issues raised in this case is *Burke-Divide Oil Co. v. Neal,* 73 Fed. (2d) 857. There the taxpayer had located claims and spent considerable amounts for development work on certain lands on the boundary line between Texas and Oklahoma. Litigation over the title arose, and the proceeds of production were impounded by order of court. The Supreme Court finally determined that the claims were void and that the taxpayer had no interest at all in the impounded funds. (*Oklahoma v. Texas*, 258 U. S. 574, 602.) Thereafter, Congress passed the Act of March 4, 1923, authorizing the Secretary of the Interior to adjust "equitable claims" and to turn over the impounded funds to such claimants after deducting an eighth as royalty for the United States. Pursuant to said Act, the taxpayer received a portion of the impounded funds in 1926 and executed a lease for the future. The Circuit

Court of Appeals, Seventh Circuit, affirmed the finding of the District Court that the receipt of the impounded funds was not a gift, but constituted taxable income.

The record in the *Burke-Divide* case discloses clearly that the taxpayer was allowed a full depletion deduction in 1926 with respect to the impounded funds received by it in that year. Paragraph XXXIII of the Findings of Facts, page 31 of the Transcript of Record in that case, states as follows:

> "That of the said residue in the amount of $762,-320.37, the Commissioner of Internal Revenue excluded from gross income of the plaintiff for the calendar year 1926 the sum of $127,053.39, paid, as aforesaid, to placer holders as accumulated royalties; and from the amount of said residue included in the gross income of the plaintiff for the calendar year 1926, that is to say, from $635,266.98, the said Commissioner deducted as an allowance for depletion 27½% thereof, that is to say, he deducted $174,-698.42; and thus included in the taxable net income of the plaintiff for the calendar year 1926 on account of the said payment by the Secretary of the Interior to the plaintiff, the sum of $460,568.56, and no more.
>
> "The total depletion allowed by the Commissioner was $189,471.29."

In other words, the Commissioner held that the Burke-Divide Oil Co. had an "economic interest" in the property and was entitled to a depletion deduction on the impounded funds, even though the Supreme Court had made a final adjudication that the taxpayer's claims were null and void.

In our case, the facts are far stronger. There never has been a final adjudication of the title, so it cannot fairly be said that appellant had no title. On the contrary, the nature of the settlement recognized the ownership of a very substantial "economic interest" in the property throughout the period of receivership.

If the Commissioner was correct in allowing depletion with respect to the impounded funds to the Burke-Divide Oil Co., where the Supreme Court had held their claims to be null and void, it follows beyond question that appellant is entitled to depletion in the present case.

It should also be noted that the depletion provisions in the 1918 Act, as quoted above, provide fundamentally for a "reasonable allowance for depletion according to the peculiar conditions in each case." Unlike the earlier laws, there is nothing in the 1918 Act basing the computation on "the output for the year" or on "the product mined and sold during the year." Under the Act here in question, Congress clearly intended that depletion should follow the income and should be determined at the same time and under the same law.

The long-established interpretation of the law by the Department, recognizing that claimants like appellant had depletable interests, which interpretation is now fortified by the decisions of the Tax Board and the courts, as cited above, should be followed as against the isolated argument of a collector that the Department's interpretation was erroneous.

## Conclusion.

It is respectfully submitted that the action of the court below should be reversed and the case remanded with instructions to the court to redetermine the tax liability and resultant refund in accordance with appellant's contentions herein.

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# APPENDIX

Reprint of Law Opinion 1110, published in the Internal Revenue Bulletin, Cumulative Bulletin II-1 (January-June, 1923), printed by the Government Printing Office in 1923. The page numbers herein and the print follow exactly the original publication.

## SECTION 214(a)10.—DEDUCTIONS ALLOWED: DEPLETION.

ARTICLE 203: Amount returnable through depletion and depreciation deductions in the case of lessee. II-2-705 L. O. 1110

INCOME TAX—DEPLETION: SECTIONS 214(a)10 AND 234(a)9, REVENUE ACT OF 1918.

Where a taxpayer prior to March 1, 1913, made claim under the placer mining laws to public land, included in the description of lands withdrawn by Executive Order of September 27, 1909, and later accepted a lease under the provisions of the Act of February 25, 1920, no final adjudication having been made as to the taxpay-

er's title or interest, such taxpayer is entitled to a depletion deduction under sections 214(a)10 and 234(a)9 of the Revenue Act of 1918, based upon the value as of March 1, 1913, of his claim or interest in the property.

Solicitor's Opinion 118 (C. B. 5, p. 160) overruled.

In a number of cases which have been referred to this office taxpayers have requested a reconsideration of the ruling contained in Solicitor's Opinion 118 (C. B. 5, p. 160), the published headnote of which is as follows:

Where a taxpayer made claim under the placer mining laws to public land, which was withdrawn by Executive order prior to completion of valid location (and prior to March 1, 1913) and later (subsequent to March 1, 1913) operated the land under agreement with the Secretary of the Interior, or lease from the Government, he is not entitled to a depletion deduction based upon the value of his claim as of March 1, 1913, but, under the provisions of the Revenue Act of 1918, he is entitled to a depletion deduction based upon the discovery value as to discoveries made subsequent to the acquisition of the lease or leases from the Government.

The circumstances in the various cases pending in this office are substantially the same. The facts, therefore, which give rise to the question, the correct solution of which involves the tax liability of a number of taxpayers, may be stated generally.

Prior to and subsequent to September 27, 1909, a large number of locations were posted under the placer mining laws upon petroleum lands situated in California and Wyoming. These claims, which were freely bought and sold both prior and subsequent to 1909, had varying values dependent upon proximity to producing fields and other circumstances.

On September 27, 1909, the President issued an Executive withdrawal order, known as Temporary Petroleum Withdrawal No. 5, in the following language:

In aid of proposed legislation affecting the use and disposition of the petroleum deposits on the public domain, all public lands in the accompanying lists are hereby temporarily withdrawn from all forms of location, settlement, selection, filing, entry, or disposal under the mineral or nonmineral public land laws. All locations or claims existing and valid on this date may proceed to entry in the usual manner after field investigation and examination.

The accompanying lists embraced 3,041,000 acres of land.

It was immediately contended by claimants of the land involved that the issuance of the order was not within the authority of the Executive, and that the order was invalid. This appears to have been the best legal opinion at that time, as is demonstrated both by the opinions of the trial judges who passed upon the question (*United States* v. *Midwest Oil Company,* 206 Fed., 141; *United States* v. *Midway Northern Oil Company,* 216 Fed., 802; *United States* v. *McCutchen,* 217 Fed., 650), and by the opinion of one of the leading authors on mining law (Lindley on Mines, 3d ed., sec. 200(b), Vol. I, p. 439). Furthermore, the President, acting upon the advice of the law officers of the Government, in several messages to Congress expressed doubt as to the validity of the order itself and requested legislation validating the withdrawals.

The action taken by Congress, following the messages from the Executive, is expressed in the Act of June 25, 1910 (36 Stat. L., 847) (amended August 24, 1912 (37 Stat. L., 497)), wherein authority was granted to the President to issue such withdrawal orders in the

§214(a)10, Art. 203.]
future. The Act, however, specifically provided that it should not be "construed as a repudiating abridgment or enlargement of any asserted rights or claims initiated upon any oil or gas bearing land after any withdrawal" made prior to its passage.

The Act contains the following saving clause:

*Provided,* That the rights of any person who, at the date of any order of withdrawal heretofore or hereafter made, is a bona fide occupant or claimant of oil or gas bearing lands and who, at such date, is in the diligent prosecution of work leading to discovery of oil or gas, shall not be affected or impaired by such order so long as such occupant or claimant shall continue in diligent prosecution of said work. * * *

After the withdrawal order the claims to the land embraced within its provisions continued to be dealt in due to the generally accepted opinion as to the invalidity of the order and the fact that a great majority of claimants contended that, in any event, they were within the above-quoted saving clause of the 1910 Act. The value of the claims is demonstrated by the substantial considerations for which they were transferred during 1909 and subsequent years, particularly in those cases, which were many, where oil and gas were discovered in paying quantities prior to 1913.

Prior to 1912, the claim of the United States to the lands described in the withdrawal order was not asserted. In 1912 and 1913, however, a few suits were instituted by the Government, some in cases where notices of location were posted prior to the withdrawal and some in cases where the notices had been posted after the withdrawal order. Beginning in 1914, a large number of suits were filed against the various claimants, including the taxpayers who present the pending question and whose claims were acquired between 1900 and 1913. The defense presented in these suits was that the withdrawal order was invalid and that, in any event, the properties involved in litigation were within the saving clauses of the withdrawal order and the Act of June 25, 1910. As to many claimants, proceedings were pending in the Department of the Interior looking toward the determination of title, and as to some of them, ancillary suits were pending in the courts. Substantially the same defense was made in the various departmental proceedings as was made in the courts.

Pending the adjudication of title and the rights of the parties, the properties were operated and all, or a portion, of the net proceeds of the sale of oil produced were impounded, either under voluntary agreements between the claimants and the Secretary of the Interior pursuant to the Act of August 25, 1914 (38 Stat. L., 708), or by order of court in receivership proceedings. The manner of operation of the properties between 1909 and 1921, however, does not affect the solution of the question presented.

The validity of the withdrawal order was presented to the Supreme Court in *United States* v. *Midwest Oil Company* (236 U. S., 459), decided in February, 1915. The case did not involve the saving clauses of the withdrawal order or the Act of June 25, 1910, the location having been made subsequent thereto. The Supreme Court held the order to have been properly issued.

In view of this decision, the taxpayers who presented the pending question were obliged to rest their defense in the suits filed against them by the Government upon the proposition that, upon the date

of the withdrawal order, they were bona fide occupants or claimants of the land and in diligent prosecution of work leading to discovery of oil and gas, and consequently were within the saving clauses of the withdrawal order and the Act of June 25, 1910. On February 25, 1920, these cases were pending either in the trial courts or in the appellate courts, no final adjudication having been rendered upon the claims of any of the taxpayers who have raised the question under discussion. On the same date many other cases were pending in the Department of the Interior.

On February 25, 1920, the so-called Leasing Act was passed, of which the portions affecting this discussion are:

SEC. 18. That upon relinquishment to the United States, filed in the General Land Office within six months after the approval of this Act, of all right, title, and *interest claimed and possessed* prior to July 3, 1910, and continuously since by the claimant or his predecessor in interest under the preexisting placer mining law to any oil or gas bearing land upon which there has been drilled one or more oil or gas wells to discovery embraced in the Executive order of withdrawal issued September 27, 1909, and not within any naval petroleum reserve, and *upon payment as royalty* to the United States of an amount equal to the value at the time of production of one-eighth of all the oil or gas already produced except oil or gas used for production purposes on the claim, or unavoidably lost, from such land, the claimant, or his successor, if in possession of such land, undisputed by any other claimant prior to July 1, 1919, shall be entitled to a lease thereon from the United States for a period of 20 years, at a royalty of not less than 12½ per centum of all the oil or gas produced except oil or gas used for production purposes on the claim, or unavoidably lost: * * *

All such leases shall be made and the amount of royalty to be paid for oil and gas produced, except oil or gas used for production purposes on the claim, or unavoidably lost, after the execution of such lease shall be fixed by the Secretary of the Interior under appropriate rules and regulations: * * *

No claimant for a lease who has been guilty of any fraud or who had knowledge or reasonable grounds to know of any fraud, or who has not acted honestly and in good faith, shall be entitled to any of the benefits of this section.

Upon the delivery and acceptance of the lease, as in this section provided, all suits brought by the Government affecting such lands may be settled and adjusted in accordance herewith and all moneys impounded in such suits or under the Act entitled "An Act to amend an Act entitled 'An Act to protect the locators in good faith of oil and gas lands who shall have effected an actual discovery of oil or gas on the public lands of the United States, or their successors in interest,' approved March 2, 1911," approved August 25, 1914 (38 Stat. L., 708), shall be paid over to the parties entitled thereto. * * * (41 Stat. L., 437, pp. 443, 444.)

Shortly after its enactment, these taxpayers and others similarly situated made application for leases under the provisions of the statute. The necessary formalities were complied with; quit-claim deeds to the United States were executed and delivered; leases from the United States were executed by the Secretary of the Interior and delivered to the claimants; of the impounded funds, an amount equal to one-eighth of the value of the oil and gas produced was paid over to the United States and the balance paid over to the taxpayers, such payments taking place in some cases in 1920 and in other cases in 1921. The pending litigation was disposed of by final judgments (which, in cases then pending on appeal, were pursuant to mandates of the appellate courts) which did not adjudicate the question of title, but directed merely that action should be taken in accordance with the 1920 statute, pursuant to stipulation of the parties.

The question presented is whether or not, under the circumstances set forth above, the taxpayers had such an interest as of March 1,

1913, within the meaning of the Revenue Act of 1918 as to entitle them to an allowance for depletion based upon the value thereof, if any.

Section 214(a)10, governing the deductions of individuals, and section 234(a)9, governing the deductions of corporations, are identical, the material portions reading as follows:

That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

*  *  *  *  *  *  *

In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, * * * the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within 30 days thereafter; * * *. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *

It is to be observed that under the above-quoted provisions of the Revenue Act it is not a condition precedent to the allowance of the depletion deduction that the taxpayer have a fee simple title to the mineral lands involved. It is expressly provided that the allowance shall be based upon the value of the property or the taxpayer's *interest therein.* The interest may be the highest kind of property, namely, the fee, but it may also be less. The character of the interest will determine the right to the deduction and the value of the interest will determine the amount of the deduction.

No location of a mining claim, valid as against the Government, can be made until the discovery of mineral within the limits of the claims (R. S., secs. 2320-2329). Discovery and appropriation are the sources of title. Posting a notice on public land, claiming the same as a mining claim, and recording such notice without first making a discovery, is a mere speculative proceeding, conferring no rights as against the Government, although as long as the so-called locator remains in possession and with due diligence prosecutes work toward discovery, he may be entitled to protection against "all forms of forcible, surreptitious, or clandestine entry or intrusion upon his possession" by another. (*Erhardt* v. *Boaro,* 113 U. S., 527; *McLemore* v. *Express Oil Co.,* 112 Pac., 59 (Cal.); *United States* v. *Midway Northern Oil Co.,* 232 Fed., 619.) Such claimants, therefore, who had not made discovery at the date of the withdrawal had no right or claim to the lands they were claiming, valid as against the United States, nor could any right be initiated by an entry after the date of such order, unless some rights were conferred by the Act of June 25, 1910. To come within the saving clause of that Act, it was essential that the party claiming the benefit thereof be a bona fide occupant or claimant at the date of the withdrawal and at that time in diligent prosecution of work leading to a discovery. In the absence of a discovery and in the absence of diligent prosecution of work leading to a discovery, even though in actual possession of the property as against the Government, a claimant was subject at any time to the possibility of a withdrawal of the privileges offered him

and consequent termination of his right to go upon the public domain and explore for mineral.

What then was the interest of these taxpayers on March 1, 1913, in the oil properties involved. That Congress recognized the equities of the claimants is apparent from a reading of the so-called relief provisions of the Oil Land Leasing Act and the committee report which accompanied that bill. So much of the report of the Committee on Public Lands of the House of Representatives as tends to disclose the purpose of Congress is quoted as follows:

Section 18 is one of the so-called relief sections. This section applies to limited areas of oil lands upon which production has been developed by the claimants and where a controversy has arisen between the Government and such claimants as to the validity of the claims. The controversy affecting these disputed lands arose out of the different interpretations placed upon the original Executive orders under which the land was withdrawn from entry. At the time of such withdrawals claimants had the right under the placer law to prospect and locate public lands for oil, and many such claimants alleged that they were upon their claims prosecuting work of discovery when the withdrawal order was made; others were temporarily absent. A doubt as to the legality of the withdrawal order was quite generally entertained and several Federal courts in western jurisdictions held that the same was invalid. As a result many claimants remained on their claims and millions of dollars were spent in developing the same. Suits were instituted by the Government, many of which are now pending. Several of these suits have been decided adversely to the Government by the Federal District and Circuit Courts. The litigation has been expensive for the Government and as yet no final judicial determination of the right of the claimants as a whole has been had.

In the several conservation bills passed in preceding sessions the Congress has recognized that the claimants had distinct equities, and the relief sections passed in previous bills have provided for a relinquishment by the claimants, and the issuance by the Government to them of leases upon a royalty of not less than one-eighth, the maximum to be fixed by the Secretary of the Interior. * * *

The effect of section 18 will be to restore to the Government an ownership in all the lands in controversy and the payment to the Government of one-eighth royalty on all oil produced on the lands from discovery, and, in addition thereto, insures the payment to the Government of such royalty not less than one-eighth as may be fixed by the Secretary of the Interior on future production.

It will be noted from the excerpt from the committee report set forth above that section 18 was designed to settle the disputes between the Government and the oil claimants, and while in terms not a compromise measure, had many of the earmarks of one. The oil claimants desiring to come within this section of the Act were required to relinquish to the United States all the right, title and interest possessed by them under the preexisting placer mining laws to the lands in controversy and pay to the United States as royalty the amount named in the Act. The claimants were to receive a lease to the land and all the profits theretofore made by the operation of the properties, other than the one-eighth royalty, turned over to the Government. The substantial effect of this settlement was to treat the oil claimants as if they had been operating under a lease from the Government from the beginning.

It has been argued by one of the taxpayers that irrespective of any title it may have had by virtue of locations under the placer mining law it did have possession to the land, a possession in which it was protected by the courts, and that possession is in and of itself an interest in land. In support of this position the taxpayer cites the case of *Swift v. Agnes* (33 Wis., 228), wherein the court held

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that bare possession is such an interest in land as will permit one to maintain ejectment; and the cases of *Merwin* v. *Backer* (80 Conn., 338, 68 Atl., 373) and *Morse* v. *Inan* (42 Ill., 150, 89 Am. Dec., 317), wherein it was held that proof of possession without proof of ownership is sufficient to enable a plaintiff to maintain an action of trespass and to recover for damages done to the property. In the case of *Crossman* v. *Pendery* (8 Fed., 693) the court stated:

> A prospector on the public mineral domain may protect himself in the possession of his *pedis possessionis* while he is searching for minerals. His possession so held is good as a possessory title against all the world, except the Government of the United States.

In the case of *Tarpy v. Madsen* (178 U. S., 215) the Supreme Court recognized the fact that possessory rights to public lands are of value and are frequently made the subject of barter and sale.

While recognizing the force of the taxpayer's argument, this office is not prepared to accede to the position advanced that the bare possessory right to land in and of itself constitutes such an interest therein as to entitle the taxpayer to the depletion allowance provided by the Revenue Act of 1918. It is believed, however, that the taxpayers have something more than the bare right to the possession, though they clearly had that, a possession in which they were fully protected by the courts against all forms of forcible, surreptitious, or clandestine entry or intrusion. In addition they were there under a claim of title asserted under the placer mining laws of the United States and pursuant to locations duly posted on the land, and their claim to title, though contested by the Government, had never been finally and successfully challenged by the final judgment of any court. Decisions against the claimants in the lower courts had been appealed. Decisions in their favor had been carried to the higher courts by the United States. That the interest of the taxpayer had a very substantial value is evidenced by the large amounts for which a number of the properties involved were conveyed prior to and during 1913. Without attempting to give a more comprehensive name to the interests of the taxpayers in the oil properties on March 1, 1913, there is no question that at that time and at all subsequent times until the acceptance of a lease from the Government the taxpayers had such an interest in the properties in question sufficient to bring them within that term as used in section 214(a)10 of the Revenue Act of 1918, i. e., such an interest as to entitle them to the depletion allowance provided in the statute.

It should be borne in mind that many of the taxpayers purchased the properties in question in good faith prior to March 1, 1913, paying a substantial consideration therefor. It has been the consistent practice of the Bureau to deny any deductions for losses which may arise as a result of litigation involving a determination of title to land until final adjudication by the courts. In the cases under consideration there has never been a final adjudication of title. These taxpayers under the established practice could under no circumstances have been allowed a deduction from the income received from other sources for the losses which they sustained in purchasing what they believed to be good title to the properties involved. To deny a deduction for the loss sustained and also to deny a deduction for depletion would lack consistency. One denial would be to assert title in the taxpayer and the other to negative such title.

It is accordingly held, that where a taxpayer prior to March 1, 1913, made claim under the placer mining laws to public land included in the description of lands withdrawn by Executive order of September 27, 1909, and later accepted a lease under the provisions of the Act of February 25, 1920, no final adjudication having been made as to the taxpayer's title or interest, such taxpayer is entitled to a depletion deduction under sections 214(a)10 and 234(a)9 of the Revenue Act of 1918, based upon the value as of March 1, 1913, of his claim or interest in the property.

Solicitor's Opinion 118 overruled.